China's New Normal and the Pace of Reforms

Fresh from a trip to China, Sean Miner discusses the country's efforts to balance a gradual slowdown in the world's second largest economy with the ongoing need for economic reforms, including more currency flexibility.

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Pedro da Costa: I'm Pedro da Costa, Editorial Fellow here at the Peterson Institute for International Economics joined by Sean Miner, he's our China Program Manager and he's back from a recent trip to Asia. Welcome.

Sean Miner: Thanks for having me.

Pedro da Costa: So, if you could talk about a little bit about what the purpose of these Asia trips that the Peterson Institute does. And what the highlights of this year's trip were?

Sean Miner: Sure. So, the Peterson Institute does an annual trip to China every May. This was our fifth annual trip and we partner with the Chinese think tank called China Finance 40 and we hold a two-day conference on various economic issues, sometimes between the US and China but more on Chinese economy and its reformed efforts going forward. But while we're there, we also take meetings at various economic policy departments and regulatory agencies.

So, this time, we went to see their banking regulator and the securities regulator, also the central bank but the main highlight of our trip was seeing and visiting the Vice Premier Wang Yang. So he told us a little bit about the state of China's economy and its economic reforms where he compared China's economy to a giant ship and it is a very delicate process steering this ship and you don't want to turn too quickly. So, the theme from his meeting was basically that China's economy is moving forward, relatively stable but they don't want to have very fast reforms in the near term. I think the message was that any changes will come gradually.

Pedro da Costa: Sure. And now when he talk about turning too quickly, the idea is that there's been a longstanding push from Western economists and policymakers for China to move away from an export-driven model that included some attempt to keep its currency undervalued for a time to a more consumer-based model, which it could certainly support given the size of its population. And so, to expand perhaps the social safety net and get people to spend more.

And in particular, there's been reforms aimed at making the economy more market-friendly particularly in the foreign exchange arena. Do you sense that in the area of exchange rates that China's commitment to free-floating currency has waned given its acceptance into the IMF's SDR basket recently?

Sean Miner: well, I think what the Chinese authorities are worried about is exchange rate volatility herding what we call the stabilization of the Chinese economy. So China's growth rate has come down from double digit rates about five years ago to around 6% to 7% now. And, what the Chinese authorities have conveyed to us is that they are worried about significant fluctuations in the exchange rate. Does that mean that they are still moving towards a market-based exchange rate? I don't think so. But maybe the timeline has shifted and they are taking things very slowly.

There's another area where I would say there can be a gradual shift and things are moving in the right direction, but at a pace slower than a lot of Western economies would like to see.

Pedro da Costa: And so, what else was on the minds of either the policymakers that you spoke to or facts that you noticed throughout about the economy? Of course, a lot of the volatility that we've seen in financial markets over the last year has been related to doubts about is China strong or is China weak? In fact, today's headline was Global Stocks Weaken On Renewed Fears Of China Economic Growth. So, what was your sense of where growth is headed there?

Sean Miner: So, a couple things here. What was a theme across many of our meetings was the issue of Chinese credit growth. And while I would say that they aren't worried about the absolute number of credit, the absolute figure of credit, they're worried about the credit growth, the pace of credit growth and what has happened in the past two or three years has been tremendous, and definitely something for them to worry about.

So, they [overlapping conversations 00:04:21]--

Pedro da Costa: That's been pacing economic growth, right?

Sean Miner: By double figures maybe. So, the goal here is to get credit growth lower than GDP growth, which is going to be difficult because it's been growing more than 10% for the past three quarters. And so, they are concerned about this. My feeling is that they have some measures that they want to move forward. So what we heard about when we're there was this recent article in People's Daily talking about authoritative figure states that China's economy is not going to be U-shaped or V-shaped but it's going to be L-shaped. So it's come down and we're going to see kind of flat pace of growth.

So around 6% to 7% for the next few years is what the message was and how they're going to do that is with supply side reforms. We heard this theme the whole week and what it means I think is that they are looking at state-owned enterprise reform and overcapacity. So they need to reduce capacity in a lot of the industry.

And the specific one we talked about a lot was in the steel industry where we have tremendous amounts of capacity to produce steel. China is exporting a lot of its overcapacity in the global market; this has brought prices down and caused really problems all around the globe.

And so, that's something we also saw that I think is changing the past few -- the Chinese are now thinking a lot more about spillovers from its economy to the global economy. And, they're much more conscientious of what's happening and they want to ensure a relatively calm path back down to normal growth. They want to stabilize these industries that have been become unbalanced in the past several years. And so, the struggle is can they do that without seeing a slow spike in growth going forward?

Pedro da Costa: Sure. And this is my last question, which is, does that mean if they're focused on the supply side, does that mean that there's a weak appetite for kind of fiscal measures in the aggregate demand? Because it would seem that if you're trying to rebalance in those consumption, then you would want people to have some kind of spending boost to their bottom lines and to feel wage growth and to feel that kind of immediate stimulus. Do they have the fiscal firepower to keep going? The sense is that they're a quasi-communist government so they have infinitely deep pockets. That's kind of the Western sense. How much truth is it with that?

Sean Miner: Well, what we heard is China thinks that its economy has relied too much on monetary policy. And so, there is a very deliberate shift to push the economy forward with fiscal policy measures. They've recently revamped their tax system for businesses and they are looking at cutting taxes for consumers. This will help boost consumption and help rebalance the economy in the longer term.

But what I must emphasize is that the timeline for a lot people, they would like to see things happen in the next six months. I would say the timeline is more or like three to four years.

Pedro da Costa: Okay, very interesting. Thank you so much and I'm sure we'll be talking about it more.

Sean Miner: Sure.

Pedro da Costa: Thanks very much.

Sean Miner: Thanks.